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**BEFORE THE POSTAL REGULATORY COMMISSION**
**WASHINGTON, D.C. 20268-0001**

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| **Notice of Market-Dominant Price Adjustment** | **Docket No. R2012-3** |

# COMMENTS OF PITNEY BOWES INC.

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## I. INTRODUCTION

Pursuant to Order No. 921, Pitney Bowes Inc. (Pitney Bowes) respectfully submits these comments in response to the United States Postal Service's (Postal Service) October 18, 2011 Notice of Market-Dominant Price Adjustment (Notice). These comments address the following issues: (1) compliance with the statutory price cap; (2) deficiencies in some First-Class Mail prices; and (3) sufficiency of the time provided for implementation.

## II. DISCUSSION

### A. Compliance with the Annual Limitation

Section 3622(d)(1)(C) of the Postal Accountability and Enhancement Act (PAEA) requires the Commission to assess the compliance of the noticed price adjustments with the statutory price cap.[1] *See* 39 U.S.C. § 3622(d)(1)(C). Pursuant to the Commission's rules, the annual limitation is measured using the U.S. Department of Labor's Consumer Price Index for All Urban Consumers (CPI-U). *See* 39 C.F.R. § 3010.11. As set forth in Attachment C of the Notice, the Postal Service calculated an annual limitation of 2.133 percent. *See* Notice, Attachment C. Based on our review of the Notice, including the accompanying attachments, it appears that the planned price adjustments for First-Class Mail, measured using the formula in part 3010.23(b), are at or below the annual limitation established in part 3010.11 and part 3010.28. *See* 39 C.F.R. §§ 3010.11, 3010.23(b), and 3010.28.

### B. First-Class Mail Prices

Notwithstanding compliance with the price cap, some First-Class Mail prices are inconsistent with the law.

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[1] *See* Pub. L. No. 109-435, 120 Stat. 3198 (Dec. 20, 2006). The PAEA amends various sections of title 39 of the United States Code. Unless otherwise noted, section references in these comments are to sections of title 39.

1. <u>The Proposed Prices are Inconsistent with the Workshare Limitations Under Section 3622(e).</u>

The PAEA directs the Commission to "ensure that [workshare] discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity" unless certain criteria are met. *See* 39 U.S.C. § 3622(e)(2). Additionally, rule 3010.14(b)(6) requires the Postal Service to provide "[s]ubstantial justification for all proposed workshare discounts that exceed avoided costs." 39 C.F.R. § 3010.14(b)(6).

A defining feature of the proposed First-Class Mail prices is the combination of the AADC and 3-Digit Automation Letters workshare tiers. This makes sense given USPS processing practices.[2] At the same time, the Postal Service: (1) increased the MAADC to AADC workshare discount from 100 percent to 143 percent of the measured costs avoided; and (2) reduced the discounts (or increased the price) for the 3-Digit and 5-Digit Automation Letters rates. Neither of these changes can be justified on the record before the Commission.

Without citing any of the specific statutory exceptions to the workshare limitation, the Postal Service attempts to justify the increase in the MAADC to AADC passthrough in two ways. First, the Postal Service observes that it currently has excess capacity in its incoming mail processing operations. *See* Notice at 35. Justifying deviations from 100 percent passthrough based upon the presence of excess capacity does not augur well for mailers, the Postal Service, or efficiency. Pricing to excess capacity is not a long-term solution for the Postal Service. The solution is to shed the excess capacity in the network. Moreover, the explanation does not withstand scrutiny. Moving mail from MAADC to AADC eliminates an outgoing processing sort, but has no meaningful impact on the number of incoming sorts that are required, i.e., while

[2] In fact, Pitney Bowes has previously urged the Postal Service to consider making this change because of the relative similarity in incoming sort schemes for AADC and 3-Digit Automation Letters. *See* Dkt. No. RM2011-5, Pitney Bowes Inc. Comments (Jan. 28, 2011), at 3.

AADC mail avoids all outgoing sorts, it is processed in essentially the same way as MAADC mail in incoming operations.[3] Rather, the proposed rate design attempts to soak up excess capacity in incoming operations by moving mail back from the 5-Digit Automation tier. And the Postal Service rate design encourages this shift by substantially reducing the effective passthrough from AADC/3-Digit to 5-Digit.

Second, the Postal Service attempts, but fails, to justify the increased MAADC to AADC passthrough as a necessary consequence of the combination of the AADC and 3-Digit rates. *See* Notice at 35. The combination of these pricing tiers may help reduce the impact of future network optimization plans as claimed but it does not justify an excessive passthough. Limiting operational steps should be encouraged and service considerations are also important, but these considerations apply to all pricing and, if accepted here, would justify passthroughs of more than 100 percent across the board. Moreover, the Notice is contradictory. At the same time the Postal Service proposes to hike the passthrough from MAADC to AADC from 100 percent to 143 percent, it proposes to reduce the effective passthrough for the 5-Digit rate from 96 percent to 83 percent[4] – the latter proposal is completely incompatible with a stated goal of encouraging worksharing to minimize the number of processing steps. *See* Notice at 35.

The proposed prices are inconsistent with the workshare limitations of section 3622(e). The AADC Letters discount exceeds 100 percent of the costs avoided and the Postal Service has failed to justify the excessive passthrough. The Commission should direct the Postal Service to move all of the passthroughs within Presort Letters closer to 100 percent. This can and should be

[3] *See* Dkt. No. ACR2010, USPS-FY-10_FCM_PRST_LETTERS_MPFinal.xlsx, "DENSITY"; Dkt. No. RM2011-5, PRC Order No. 741 (Jun. 3, 2011), at 5 ("For these reasons, the Commission finds that the proposed modification of the automation density table to assume that no presort letters flow from outgoing sorting operations to the incoming secondary operation is likely to improve the accuracy of the letter cost avoidance models and is accepted.").

[4] Based on the current PRC-approved cost avoidance models the avoided costs between the new "combined" AADC / 3-Digit rate and the 5-Digit Automation Letters rate is 2.9 cents, the effective discount is only 2.4 cents.

done without increasing the AADC/3-Digit Automation Letter price.[5] As discussed below, a more appropriate rate design would impose a smaller burden on First-Class Mail Presort Letters.

Additionally, while the PAEA does not impose a minimum passthrough of avoided costs for workshare discounts, several of the rate setting objectives and factors under the PAEA (including section 3622(b)(1) on incentives to increase efficiency and section 3622(c)(5) on reflecting the degree of mail preparation) envision workshare discounts that reflect the full measure of the costs avoided. *See* 39 U.S.C. §§ 3622(b)(1), 3622(c)(5). Rule 3010.14(b)(6) requires the Postal Service to "identify and explain discounts that are set substantially below avoided costs and explain any relationship between discounts that are above and those that are below avoided costs[.]" 39 C.F.R. § 3010.14(b)(6).

The Postal Service has failed to provide any explanation for the substantial reduction of the 5-Digit Automation Letters discount. Accordingly, the Commission should direct the Postal Service to explain why the 5-Digit Automation Letters discount was reduced and explain the relationship between the 5-Digit Automation Letters discount and the discount proposed for AADC Letters.

2. <u>The Proposed Prices are Inconsistent with the Rate System Objectives and Factors of the PAEA.</u>

Under the CPI cap the amount of revenue that the Postal Service can collect is constrained, but because the unit contributions from different products are different, not all revenue is equal. In First-Class Mail, the unit contribution of First-Class Mail Presort Letters / Cards (23.7 Cents) is more than five cents greater than the unit contribution of First-Class Mail

[5] This could be accomplished by accompanying the smaller MAADC-AADC passthrough and larger AADC/3-Digit to 5-Digit passthrough with a reduction in the well-above-average (3.6%) price increase being proposed for MAADC Automation Letters.

Single-Piece Letters / Cards (18.5 cents).[6] In view of the financial challenges facing the Postal Service, this difference in relative contribution should drive the rate design for First-Class Mail. This is especially true where, as here, First-Class Mail Presort Letters are more price sensitive than Single-Piece Letters.[7] Yet the most recent price adjustments move in the opposite direction.

In the previous pricing adjustment filed in January of this year, the Postal Service correctly observed that 5-Digit Automation Letters account for almost 50 percent of the volume of Automation Letters, thus, a reduction in the price of this product (via the expansion of the 3-Digit to 5-Digit workshare discount) would help retain many of its largest customers and much of its most profitable mail.[8] *See id*. Less than a year later the Postal Service has proposed prices that penalize these same customers.

The price increase on the Postal Service's most profitable, most finely-presorted letter products exceeds the relative price increase on first-ounce Single-Piece letters.[9] The first ounce Single-Piece letter increase is 2.3 percent whereas first ounce 5-Digit Automation Letters increase 2.9 percent. With this disproportionate increase the Postal Service misses an opportuity to use its pricing flexibility to retain its most profitable, most finely presorted products. The cumulative increase for first ounce Single-Piece letters over the past two pricing adjustments is 2.3 percent, considerably less than the CPI increase over the same period (3.9 percent), and nearly half the price increase (4.5 percent) for first ounce 5-Digit Automation Letters over the same period.

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[6] *See* FY 2010 Annual Compliance Determination Report (Mar. 29, 2011), at 84.

[7] *See* PRC Narrative Explanation of Econometric Demand Equations for Market Dominant Products Filed with Postal Regulatory Commission on January 20, 2011 (Jul. 1, 2011), pp. 35 and 39.

[8] *See* Dkt. No. R2011-2, United States Postal Service Notice of Market-Dominant Price Adjustment (Jan. 13, 2011), at 13.

[9] Pitney Bowes recognizes that the Postal Service's efforts to add value to First-Class Presort Letters by offering a blended second ounce price, however, because 95 percent of First-Class Mail Presort Letters are under one ounce, first ounces prices provide the most meaningful basis of comparison for First-Class Mail Single-Piece and Presort Letters. *See* USPS-LR-R2012-3/1

The proposed prices are financially self-defeating and inconsistent with the objectives and factors of the modern rate system under the PAEA. While the Commission has held that the Postal Service "enjoys a general prerogative to set market dominant rates,"[10] it has also held that market dominant prices must be developed with "consideration for the qualitative rate and classification objectives and factors identified in sections 3622(b) and 3622(c)."[11] The proposed First-Class Mail prices fails to give adequate consideration to the profitability and economic efficiency concerns expressed under sections 3622(b)(1) (incentives to increase efficiency), 3622(b)(5) (assure adequate revenue), 3622(c)(1)(value of mail service provided), 3622(c)(3)(effect of rate increase on mailers), 3622(c)(4)(available alternatives to mail), and 3622(c)(5)(prices reflecting degree of mail preparation). *See* 39 U.S.C. §§ 3622(b)(1) and (5), 3622(c)(1) and (3)-(5).

The pricing flexibility afforded to the Postal Service under the PAEA is an important tool to address the financial challenges currently facing the mailing industry. The Postal Service should use its pricing flexibility to lower prices on its most profitable and most price sensitive products. The proposed First-Class Mail prices do not do this.

**C. Timing of the Price Adjustment**

As it has done in the past, the Postal Service is affording more advance notice of the proposed price changes (96 days) than the law requires (45 days). *See* 39 U.S.C. § 3622(d)(1)(C); *See* 39 C.F.R. § 3100.10(a)(2). This additional time will help the mailing community prepare for and implement the proposed price changes in an orderly fashion.

[10] Dkt. No. RM2009-3, Order. No. 536 (Sept. 14, 2010), at 16.
[11] *Id*.

## III. CONCLUSION

Pitney Bowes appreciates the Commission's consideration of these comments.

Respectfully submitted:

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